

regulatory proceedings and lawsuits. But they have also grown complex to mask that they are opposed to all common sense. It is wrong to impose price controls on a competitive market. It may exact a terrible toll on consumers to the benefit of a few inefficient providers. If there is a sensible way to segment markets and apply minimal oversight to the ones that are competitive, it ought to be done. The most formidable competitive issue facing the Commission isn't difficult to resolve intellectually, but will take courage to resolve morally. The issue is protectionism. It was best described by Stephen Breyer a few years ago:

It arises when regulators or antitrust enforcers confuse means with ends by thinking that the object of the law is to protect individual firms from business risks rather than to bring consumers the price and production benefits that typically arise from the competitive process ... the consequence of misdirecting protection is to threaten to deprive the consumer of the very benefits deregulation seeks.<sup>85</sup>

"The most obvious" example of this risk, Breyer pointed out, "arises in telecommunication."<sup>86</sup> (See below, p. 90.)

There is a simple, empirical, and result-oriented test that a broad consensus of regulators, economists and antitrust experts have agreed should be the standard for price regulation. Consumers will benefit if we are given pricing flexibility in a

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<sup>85</sup> Stephen G. Breyer, "Antitrust, Deregulation, and the Newly Liberated Marketplace," California Law Review, vol. 75, p. 1018 (May 1987).

<sup>86</sup> Id.

market, so long as we don't have "the ability to raise prices or restrict output" in that market.<sup>87</sup> Period.

If a market passes this test of competition, the only remaining task for regulators (unless one is of the view that antitrust enforcers already accomplish it, as Breyer suggests one consider) is to assure that prices are not set below economic costs. Economic costs are always future costs, not historical costs. Economic costs don't include arbitrary allocations. Economic costs exactly match the business decision at hand, that is, they are the difference between a provider's total costs with and without the implementation of a new business decision.

A. Market Share: Its Definition and Significance

Our competitors have frequently alleged that we have something like 99% of the "local access market." (See, e.g., AT&T, p. 9.) The statistic is wrong and what it purports to prove is irrelevant.

First, it doesn't segment the market in any way that is economically meaningful. It combines the comparatively few areas where we make a profit with the many where we don't. A

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<sup>87</sup> See United States v. Western Elec. Co., 12 F.3d 225, 233 (D.C. Cir. 1993). See also Expanded Interconnection with Local Telephone Company Facilities, Transport Phase I, 8 FCC Rcd. 7374, para. 118 (1993); Competition, Rate Regulation and the Commission's Policies Relating to the Provision of Cable Television Service, 5 FCC Rcd. 4962, 4968 n.19 (1990); Competition in the Interstate Interexchange Marketplace, 5 FCC Rcd. 2627, para. 51 (1990); Michael L. Katz and Robert D. Willig, "The Case for Freeing AT&T," Regulation, v. 7, no 4 (July/August 1993), pp. 48-49.

complete reform of the access rules would end the subsidy from high-profit low-cost markets to low-profit high-cost markets. But until that reform occurs our ubiquity has no intrinsic advantage; it's simply an incentive to cherry-picking and inefficient entry by other providers. Our competitors don't treat "local access" as a single market. They enter the markets that are lucrative because of high demand and low cost, and avoid the rest.

If one analogy may illuminate this it's the U. S. Postal Service -- the mail carrier of last resort. An analysis similar to AT&T's "99%" would show that the Postal Service has a majority "market share." That doesn't prevent the Postal Service from losing more money every year.<sup>88</sup> If the Postal Service had real owners, they'd be more concerned about its share of the profitable markets than how much of the population it serves.

In the downtown areas of Los Angeles and Orange County, San Francisco, San Diego, and Sacramento no fewer than four CAPs offer dedicated connections. These metropolitan areas represent only 5% of the land area of California yet generate approximately 85% of business calling revenues. Our competitors

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<sup>88</sup> As a U.S. Postal Rate Commissioner testified, "it is my view that the Postal Service could hardly be worse off financially and I see nothing on the horizon that will significantly improve its present position. For example, if present trends continue, our figures indicate a possible loss in the range of \$2.4 billion for 1994 alone." The Commissioner went on to state that the aggregation of the Postal Service's prior years' losses had doubled since 1990. Prepared Testimony of Commissioner William H. LeBlanc III, Postal Rate Commission, Before the House Committee on Post Office and Civil Service, 103rd Cong., 2nd Sess. (May 24, 1994).

don't have to serve more than one-twentieth of our geographic area to address the vast majority of our business revenue base.

Second, "99%" refers only to access charges paid by IXCs. It ignores access charges paid by end users,<sup>89</sup> end users who use private networks of their own or of another provider (such as AT&T's MEGACOM or MCI's PRISM), cellular access, and perhaps most important the intraLATA self-supply capabilities of the IXC's own networks. Our largest and most formidable competitors aren't the CAPs. They're our largest customers, the IXCs. Unlike our competitors AT&T, MCI, and others, we don't have the luxury of pretending that IXCs' self-supply of access can be ignored in our market plans. Access is a "make or buy" decision for IXCs. As intraLATA competition is authorized, the attractiveness to IXCs of building their own intraLATA networks will increase.

Assuming for the sake of argument that "access" is a single market, to calculate our share of traffic the following computation would be necessary:

#### Switched + Special Access

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Switched + Special Access + CAP + IXC Self + Cellular + Private

where the Switched and Special Access numbers are from the LEC, CAP refers to special access provided by CAPs, IXC Self is the access provisioned by the IECs themselves, Cellular is cellular access, and Private refers to the capacity in private networks

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<sup>89</sup> Today about 40% of our hicap circuits are provided directly to end users, not to IXCs.

that are not telecommunications providers (such as privately constructed networks, VSAT and microwave).

The "99%", then, isn't 99% of the profitable market, and it's not 99%, either. How much smaller it is no one can determine until our competitors' ability to self-supply and other parts of the denominator are known. AT&T's enormous ability to self-supply can be garnered indirectly from the known fact that its interoffice network in California is about twice the length of ours.<sup>90</sup>

Third, "99%" refers to revenue rather than supply or demand.<sup>91</sup> As the Commission has recognized, revenue share is an indication, not a source of market power.<sup>92</sup> Since it doesn't demonstrate market power, the 99% statistic is much ado about nothing.

In the case of access services, market share happens to be a very poor index of competition. Access services are fungible and widely resold. They are purchased by sophisticated customers, all of whom have alternatives including, for most,

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<sup>90</sup> See Pacific, p. 94.

<sup>91</sup> For example, it assumes that a dollar of special access revenue represents the same share of the "market" as a dollar of switched access. Currently, 60% of the over 7,000 special access hicap (DSL equivalents) purchased by AT&T from Pacific Bell carry voice traffic. These circuits alone represent a reduction of \$100M annually in switched access revenue. Pacific Bell recovers approximately \$50M of this in special access revenues, for a net decrease of \$50M in access revenue, but as competition increases the amount of recovery will decrease.

<sup>92</sup> Competition in the Interstate Interexchange Marketplace, 6 FCC Rcd. 5880, 5890 (1991) ("Market share alone is not necessarily a reliable measure of competition, particularly in markets with high supply and demand elasticities").

supplying themselves. Thus, for the carrier access market, market power is a function of each provider's capacity, not its current revenues -- the fraction of the market that can be served by any provider.<sup>93</sup>

Therefore, while our competitors make claims about the state of the access services market, the true market power of any provider -- including us -- is unknown because we are the only ones required to file information on switched usage and the transmission capacity we have deployed. The true size of the market is unknown. Our competitors treat information about their own networks and capacity as proprietary. A small step in the right direction would be to require all providers to file specific information on the locations of their networks, as we have proposed.

What we do know about the market for carrier access services indicates there's an oversupply of capacity. The huge capacities of fiber and the amount of fiber that we know competitors have already installed in the local exchange make it highly unlikely that we could restrict supply enough to exercise substantial market power. As MCI recently said, "every carrier that has built fiber capacity has installed plenty of extra capacity."<sup>94</sup> Peter Huber has written, "Precise figures are unobtainable, but a reasonable estimate is that no more than 10%

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<sup>93</sup> See also U.S. Department of Justice, Merger Guidelines, April, 1992, reprinted at 4 Trade Reg. Rept. (CCH), para. 13.100 et seq.

<sup>94</sup> MCI News Release, October 26, 1993, "Long Distance: Public Benefits from Increased Competition," Robert E. Hall, p. 23.

of CAP fiber capacity is actually being used to carry traffic. A CAP carrying 5% of access traffic from an urban business district could readily expand to 50%, at almost no increase in cost."<sup>95</sup>

AT&T ought to know all this. In Docket 90-132 AT&T strenuously downplayed the importance of market share as an index of market power. Instead it emphasized the enormous excess capacities of its competitors' networks, as it should have. AT&T said that "the available capacity of ... competing carriers ... is the most telling indicator of the strength of competition."<sup>96</sup> AT&T complained:

AT&T's competitors could quickly take over virtually all of AT&T's business without adding any transmission facilities. This capacity -- both long-lived and sunk -- prevents AT&T (or any carrier) from sustaining prices above competitive levels or engaging in successful predation.<sup>97</sup>

AT&T argued that "the existence of this excess capacity precludes the exercise of market power by any carrier --

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<sup>95</sup> See Peter Huber, "The Enduring Myth of the Local Bottleneck," at iii, filed with Letter from William Adler, dated March 15, 1994, in this proceeding. The limit of capacity on fiber is more dependent on the terminal electronics than the number of fiber strands. The current state of technology prices the marginal minute carried by larger bandwidth terminal electronics below the price of that same minute carried by incremental fiber, but terminal electronics, like all computer technology, are rapidly getting cheaper.

<sup>96</sup> Comments of AT&T, Docket 90-132, Competition in the Interstate Interexchange Marketplace, filed July 3, 1990, p. iii-iv.

<sup>97</sup> Id., at iv.

including AT&T."<sup>98</sup> We agree with AT&T's analysis in Docket 90-132. So did the Commission.<sup>99</sup>

Having obtained significant pricing flexibility for itself, AT&T now opposes determining markets and market power for LECs according to the accepted economic principles it championed in Docket 90-132. Instead, it advocates a market share test (one that's designed for us to fail even if we lost all of our profitable markets). (AT&T, p. 18, n.24.) The inconsistency with the position that AT&T took on pricing flexibility for itself is glaring.

AT&T's inconsistency cannot be excused by contending that our markets are on the whole less competitive than AT&T's were in 1990,<sup>100</sup> because we don't seek pricing flexibility in all of our markets -- only the ones where excess capacity already exists. The USTA proposal for pricing flexibility, which uses the availability of actual customer alternatives (rather than potential alternatives) as a trigger for pricing flexibility, is extremely conservative judged next to the consensus of economists and antitrust law.<sup>101</sup>

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<sup>98</sup> Id., at 30.

<sup>99</sup> See Pacific, p. 98.

<sup>100</sup> If the variables in the equation we describe above were known, we would not be surprised if our share of all intraLATA business were considerably less than the two-thirds share that AT&T had of the long-distance business in 1990. The equation can't be completed without information known only to CAPs, IXC's, cellular providers, and others, none of whom were forthcoming with specific information about their own market shares.

<sup>101</sup> MCI misstates the proposal by saying it is premised on "contestable" markets. MCI, p. 66.



## B. Preconditions to Competition

A number of commenting parties -- most prominently AT&T (pp. 14-18) and MCI (pp. 67-72) -- urge preconditions on pricing flexibility that, in effect, would deny us any pricing flexibility at all until we've lost all profitable markets to them. In the short term AT&T advocates increasing price controls with a "density index." (AT&T, p. 44.) In the long term AT&T proposes "nine specific points" that are preconditions to considering whether pricing flexibility should be permitted in competitive markets.<sup>102</sup> "If [these nine] conditions are in place, and if it is demonstrated that competition has in fact developed, only then should the Commission consider what is an appropriate measure of the extent and viability of such competitive entry." (AT&T, p. 18 (emphasis in original)).

When that day comes, the LECs still wouldn't be allowed to price down to their cost. AT&T suggests that "metrics" should also be applied "to determine whether effective competition appears to be occurring in the local exchange market." "Chief" among these metrics is "the requirement that at least 30 percent of subscribers in an areas are in fact using alternative providers for local telephone service." (AT&T, p. 18.) For further detail AT&T refers us to its Comments on Ameritech's New Regulatory Model. (AT&T, p. 18, n.24.) We checked AT&T's Comments and they don't refer to AT&T's

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<sup>102</sup> As Clemenceau said, "The good Lord had only ten." John Bartlett, Familiar Quotations (16th ed., 1992), at 542.

"metrics". So we're unable to comment in full on this proposal. However, the following points are self-evident.

The requirement that we should have no pricing flexibility until we've lost thirty percent of our customers is needless from a regulator's perspective and ludicrous from an economist's. The effect on our business and on local competition would be devastating, because the profit centers of our business are so concentrated. AT&T isn't interested in one hundred percent of our customers. At the moment, it's only interested in the customers who would buy a cellular loop from McCaw, a MEGACOM line, or some other above-cost product. The thirty percent standard would permit AT&T to skim the cream from our business secure in the knowledge that we couldn't respond. It would be an AT&T market strategist's dream but would work to the detriment of consumers.

It's noteworthy that judged by AT&T's "metric", the Postal Service must be deemed to face "no effective competition." That might come as a surprise to any consumer who has ever faxed a letter, sent an overnight package by Fed Ex, or ordered goods from one of the majority of "mail order" retailers who ship by UPS. The Postal Service is a financial black hole largely because of price regulation that was designed to prevent "discrimination" between customer classes, but succeeded only in losing the customers who had alternatives. The Postal Service now has no market power over profitable markets, but continues to be obliged to serve 100% of the population. That's where

AT&T's market strategists would like the LECs to be in ten years.

If the threat of anticompetitive behavior can be laid to rest, as we have proposed through USTA's plan, pure price cap regulation, the reform of the separations and access charge rules, then consumers will benefit from pricing flexibility. If not, consumers will continue to subsidize access providers in competitive areas. AT&T's requirement that we lose some arbitrary proportion of market share (measured by number of customers) before any competition is deemed to exist must be judged one of the most malicious examples we have seen of the protectionist tendency that Stephen Breyer identified. (See below, p. 91 et seq.)

According to AT&T, new competitors should not be encumbered by traditional franchise requirements. (AT&T doesn't define "franchise requirements," but we assume they include such requirements as carrier of last resort, ready-to-serve capacity, averaged rates, interconnection obligations, and so forth.) New competitors, however, would have comprehensive access to every piece part of the incumbent provider's network that the competitor deems essential. AT&T also says the unbundled components should be priced based on the components' underlying economic costs. That is, there would be no subsidy contribution to high-cost markets or services, though we would continue to have the exclusive obligation to serve them. We respond to each of AT&T's nine conditions below.

(1) The franchise requirements, certification requirements, and other state policies that preclude or burden entry by alternative exchange carriers should be eliminated.

Under the present franchise obligation system, regulators imposed certain requirements on incumbent providers to ensure the preservation of universal service and to protect consumers from poor service or no service at all. These requirements included being the carrier of last resort, having facilities in place to serve all current and anticipated customers, and providing basic service at prices set by regulators that don't recover the costs to provide the service. Customers have come to expect that when they buy basic service, not only will they have the ability to make and receive calls, but they will have 24 hour access to emergency services, directory assistance, repair and operator assistance. Customers have also come to expect high standards of service quality and know that if they buy any service from the incumbent provider, they will not be abandoned. Many of these expectations, or "burdens" (as AT&T calls them), are legacies of a noncompetitive market environment that no longer exists.

In the future, competitive forces will shape most customer expectations, but regulators will continue to play an important role to safeguard the quality and availability of telephone service for all customers. New minimum requirements will need to be considered, whether they relate to service quality, universal service funding, or access to the types of support services that customers have come to expect from basic

telephone service. We believe that all competitors, old and new, should be subject to these requirements to ensure competition will benefit all consumers.

(2) Alternative exchange carriers should be assured access to necessary rights-of-way, conduits, and other pathways on the same terms and conditions as the incumbent provider.

Today, conduits and rights-of-way are available from multiple sources including cities, telephone companies and other utilities. For example, our conduits and rights-of-way are already leased to others, on a nondiscriminatory, space-available basis where capacity exists.<sup>103</sup>

(3) The assignment of phone numbers and codes should be lodged with a non-competitive neutral party, a means devised to make telephone numbers portable to the full extent economically feasible, and every end user should be able to place calls using the exchange carrier of his or her choosing without dialing access codes or other protocols not required for use of the incumbent provider's services.

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<sup>103</sup> California's three largest electrical utilities -- Pacific Gas & Electric, Southern California Edison, and San Diego Gas & Electric -- all have petitioned the CPUC for permission to provide their rights of way and facilities to telecommunications providers including MCI, TCG, and Access Transmission Services, Inc. PG&E's application was granted and the other two are pending. We know very little about these arrangements, since substantial parts of the utilities' applications were submitted to the CPUC confidentially. See Application of Pacific Gas and Electric . . ., D.92-10-039, dated October 21, 1992; Application of Southern California Edison Co. . ., D.94-06-017, dated June 8, 1994; and CPUC Agenda No. 2900, May 25, 1994. For an overview of the conventional wisdom on using electrical utilities' distribution plant to handle telecommunications, see Bob Bruce, "The Future of Fiber Optics," Public Power, vol. 51, no. 5, September-October 1993.

We support the transfer of Numbering Plan administration to an independent third party. A plan for the transfer of this administration is currently being considered by the Commission.<sup>104</sup> We recommend that a similar plan for the transfer of central office code administration be developed through an open forum of industry participants in our serving area. Number portability issues are also being addressed now in various national fora (e.g., by the United States Telephone Association (USTA), the Industry Numbering Committee (INC). There are technical feasibility and policy details to be worked out prior to implementation.

However, the lack of number portability will not deter the expansion of local competition or consumer demand for alternative local services. IXC's, CAP's, cable companies and PCS providers are all preparing to compete in local exchange markets. Investors have courted them eagerly for a piece of the action. These providers (CAP's are the most spectacular example; MFS, which has never turned a profit, has a market capitalization of nearly \$2B) are all selling at a premium to the average stock in the market, and have attracted considerable cash from overseas as well. The confidence of our competitors and their investors in their ability to compete successfully with incumbent providers such as ourselves is stunning. It belies the need for the immediate availability of number portability.

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<sup>104</sup> Administration of the North American Numbering Plan, CC Docket No. 92-237, Notice of Proposed Rulemaking, released April 4, 1994.

Consumer demand for alternative local services will depend on the choice, quality and price of services offered rather than on whether number portability is available or not. Number portability is only an issue for terminating calls, where customer concerns about telephone number changes can be greatly alleviated by the availability of number referral services.

We support a long-term solution to number portability that is technically feasible, is based on sufficient market demand and compensates us for implementation costs. In the near term, we are committed to testing various interim solutions for number portability, including Flexible Direct Inward Dialing (DID) and Remote Call Forwarding, and to determine what would best meet the needs of end user customers, other local exchange service providers, and ourselves.<sup>105</sup>

(4) Basic network components and functions and all monopoly components of the incumbent provider's local exchange service should be fully unbundled, priced, tariffed, and offered for sale in a non-discriminatory manner at non-discriminatory cost-based prices.

We support the unbundling of essential monopoly services consistent with the doctrine of essential facilities. That is, what is necessary to competitors and otherwise unavailable should be unbundled and offered for sale. AT&T's

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<sup>105</sup> Number referral services are available to customers that move or change telephone numbers. The service provides a recorded message that refers callers to the new telephone number. Pacific provides this basic referral service free of charge to residential customers for a period of three months following the number change.

unbundling proposal goes well beyond the established legal standard and is clearly intended for the benefit of AT&T. Mandatory unbundling of non-essential facilities is generally anticompetitive. This proposal is no exception.

Competition won't be stimulated and consumers won't benefit from an unbundling proposal (AT&T's) that --

- o doesn't let demand determine what should be unbundled (or conversely, what should remain bundled);
- o requires breaking apart the incumbent provider's network without regard to costs and demand;
- o results in the development of products for which no demand exists (leaving the customers of incumbent providers with the costs and no offsetting revenues); and
- o harms incentives for investment and innovation (e.g., the incumbent provider must bear all the risks of failed unbundled products while AT&T (and others) can pick and choose only the winners (at cost-based prices)).

In our Comments (p. 105), we described the "link" and "port" unbundling that we are actively pursuing with the CPUC. When these proposals are combined with existing offerings of operator services, LIDB, billing services, SS7 signaling links, and service management service, a workable platform will exist upon which competition can flourish, and the majority of request for interconnection to network capabilities can be met.



Figure 2 shows the unbundled network services now available soon to be available at the requester's "Point of Interconnection" in our central office. Our proposal to unbundle the local loop from the switch is represented by (A) the Link, and either (B) a Single Line Port, or (C) a PBX Port. This will allow other providers to interconnect their own port (dial tone) functionality to a Pacific provided link, or its link to Pacific provided dial tone via one of our ports.

Expanded interconnection allows other providers to substitute their transport for Pacific's to interconnect with the switched access services. Other providers of network facilities are interconnected to these various functions by an expanded interconnection cross connect (G).

Currently, in its tariffed switched access offerings, both interstate and intrastate, Pacific offers SS7 signaling links for interconnection between other providers' switches and Pacific's SS7 Signal Transfer Point ("STP") (A) between other providers' STPs and Pacific's STPs (I), and between a Pacific switch and the STP (J). This allows other providers full connectivity with our SS7 network.

We also offer access to designated information in our Service Control Point ("SCP") databases (K) through SS7 links. Access to the information in both the 800 database and Line Information Database ("LIDB") are currently available.

This high level of interconnection activity is expected to continue. When combined with the necessary

# INTERCONNECTION OPPORTUNITIES IN PACIFIC BELL'S NETWORK



regulatory authority, local competition should flourish. There is no need for parts-store unbundling of LEC networks.

(5) There should be comprehensive interconnection between local exchange competitors for all unbundled network components, at non-discriminatory cost-based prices.

We agree there should be reciprocal interconnection between competing local exchange carriers so that the customers of one competitor can seamlessly reach those of another competitor. Interconnection works well today in many markets including CPE, cellular, interexchange and inside wire. The key to seamless interconnection is interoperability. The piece-by-piece unbundling of LEC networks that AT&T proposes is not for the benefit of all customers. It is for AT&T's benefit.

Today, LEC networks throughout our serving area are fully interconnected. Each network conforms to industry standards to ensure that customers can reach each other seamlessly and irregardless of which carrier provides the local service. This type of reciprocal interconnection and interoperability can be adapted for competition in the local exchange environment.

(6) All prices for unbundled exchange services should be based on principles of efficiency and reflect underlying costs, in order to avoid monopoly pricing, subsidies, and price discrimination.

Today many of our services are priced well above cost (such as the access charges paid by AT&T) to provide contribution to services priced well below cost (such as

residential basic services). AT&T's proposal would solve only half the problem -- the half that would benefit AT&T the most. AT&T opposes the pricing flexibility we need to retain a share of profitable markets.

(7) The local exchange companies must impute the prices of basic network functions into the price floors of their services. This will provide incentives to set fair prices and avoid anti-competitive conduct.

The economically correct standard for imputation is that the price for our competitive retail service should exceed the economic cost of the service plus the contribution of the monopoly service used by competitors to provide their services. This standard ensures that any cost efficiencies that exist by bundling toll and switched access, for example, can be reflected in our prices.<sup>106</sup> The CPUC has already adopted and implemented the principles of imputation for competitive services provided by Pacific and included monopoly services as part of the competitive offering.<sup>107</sup>

(8) User restrictions and restrictions on resale of all non-competitive services, features and functionalities should be eliminated. The "wholesale" or "bulk" charges should

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<sup>106</sup> See Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks, R.93-04-003, Opening Comments of Pacific Bell, filed February 8, 1994, at 104-105, and Reply Comments, filed March 31, 1994, at Appendix C.

<sup>107</sup> Alternative Regulatory Frameworks for Local Exchange Carriers, D.89-10-031, 33 CPUC 2d 43 (October 12, 1989).

reflect only the underlying wholesale costs and should exclude administrative and other retail costs.

Resale and use restrictions are often needed to protect social goals such as customer privacy and subsidies for particular customer groups and service. The mechanisms used by regulators to support universal service goals, for example, are the same mechanisms that have created the pricing anomalies among our services today. Regulators have, in the past, approved toll service prices that greatly exceed their costs in order to keep basic service prices low. Restrictions on resale and use restrictions pertaining to bulk-billed toll services, in particular, were intended to preserve as much toll contribution as possible without encouraging customers to go elsewhere.

The pricing anomalies that exist today can't be sustained in an increasingly competitive environment. New mechanisms to support universal service goals need to be considered and existing pricing disparities removed. When this occurs, it will be possible to move away from most restrictions on use or resale.

(9) Unbundled basic network components should be furnished pursuant to open technical standards, with mechanisms to assure that all firms have equal access to new basic network components as they are developed.

Approved technical standards and national uniformity are critical to the interconnection of all competing networks. Uniformity and standardization increases in importance given the technological evolution of the networks of the future. For

these reasons, we fully support the work of industry fora open to all parties currently addressing these issues.

Many of AT&T's conditions aren't necessary in certain local markets. For example, the only barriers to local competition in large urban markets, such as San Francisco and Los Angeles, are local rules that limit the scope of permissible competition. The CPUC has announced its intention of ending them. Competition is already occurring in these markets. Today, IXC's and numerous CAPs are providing local services to many business users. (See Pacific, p. 71.)

Only residential and rural markets have yet to be targeted by competitors. We believe competitors may need certain conditions to provide service in these markets, such as the establishment of interconnection and interoperability among competing local network providers, the unbundling of essential facilities, and appropriate authority to new competitors to provide service, but not all nine of AT&T's conditions.

While competitors, like AT&T, clamor for preconditions to competition that are favorable (but not necessary) to them, equally important issues are overlooked. These issues stem from rules and requirements imposed on LECs that are not compatible with competition. The current rules were developed for a closed market system. With the barriers to entry falling, the rules must be changed if there is to be full and fair competition. These issues include:

- o Universal Service. LECs have primary responsibility for producing the subsidies needed to keep residential

service rates below cost (e.g., through average pricing and artificially high prices for toll and access services). With competition, however, artificially high prices cannot be sustained and traditional sources of subsidy will dry up. The future of universal service will depend on how we address some tough questions -- which services and users should be subsidized? How much subsidy is needed? How will we fund it (beyond the programs that exist today)? Who should administer the funding program?

- o Franchise and carrier of last resort obligations. As the franchise holders, LECs are required to have capacity available to serve, upon demand, all customer requests for service, and to do so at averaged prices which don't necessarily cover the cost of service to any particular customer. This system works only in the absence of competition. Once competitors enter to serve lucrative customers, the average pricing scheme breaks down and the requirements associated with being the carrier of last resort become an unfair, anti-competitive burden on the LEC. A new program that makes service available to all in a way that is consistent with a competitive market needs to be developed.
- o Pricing flexibility for competitive services. While regulatory barriers to competition have remained

intact, LECs have been afforded limited pricing flexibility. Once barriers are removed, LECs should have the same flexibility to compete as any other competitor. This includes the ability to bundle products, to offer discounts and special promotions and to be able to change prices as quickly as competitors can.

- o Equal opportunity to serve customers. New competitors will not be restricted in the ways in which they can serve customers. They will be able to integrate voice, data and video services and offer a full panoply of services to meet customers' information and communications needs, efficiently and creatively. This is the direction of local competition. Any provider that is restricted in the scope of services that can be offered will not have a real opportunity to compete in this new environment. Those restrictions that limit the ability of incumbent providers, such as Pacific, to serve customers should be removed, including restrictions on the provision of interLATA and cable programming services.

C. Asymmetrical Regulation and "Anti-Competitive" Behavior.

The contention that asymmetrical regulation is needed to promote competition is a protectionist oxymoron. It's inconsistent with the beliefs of a majority of economists and



jurists (including the Supreme Court and D.C. Circuit), and it's contrary to accepted principles of price cap regulation. As the Commission has recognized, price caps "substantially curtails the economic incentive to engage in cross-subsidization."<sup>108</sup> We propose streamlined regulation only in markets that are already served by competitors, not in monopoly markets. Removing the costs and revenues of serving these competitive markets from price caps would deter illicit cross-subsidies far better than the current rules.

USTA's proposal for pricing flexibility is, according to the standard tests for defining market power and deterring anticompetitive conduct, quite conservative. Pricing flexibility is triggered not by contestability (potential alternatives) in markets, but only if consumers have present ("addressable") alternatives. Even then, we're required to price at or above LRIC, a safeguard not ordinarily imposed on providers who don't have market power.<sup>109</sup>

Protectionist arguments may begin with premises that don't sound protectionist, for example, that cost-of-service safeguards are needed to prevent below-cost or "discriminatory"

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<sup>108</sup> Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd. 2873, 2924 (1989); National Rural Telecom Ass'n v. FCC, 988 F.2d 178 (D.C. Cir. 1993); United States v. Western Elec. Co., 993 F.2d 1572, 1580 (D.C. Cir. 1993).

<sup>109</sup> See Alaska Airlines, Inc. v. United Airlines, Inc., 948 F.2d 536, 541-42 (9th Cir. 1991), cert. denied, 118 L.Ed.2d 316 (1992). MCI complains that the contestable market theory ignores the huge cost of putting in plant. This misstates USTA's plan for pricing flexibility. Markets are not considered contestable until another provider has already entered and can serve the majority of the market's demand. Until then, stricter price regulation continues.